

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

California Water Service Company (U60W), a corporation, for an order authorizing in its Kern River Valley District a water quality memorandum account.

Application 05-02-016
(Filed February 17, 2005)

**DECISION APPROVING ESTABLISHMENT
OF ARSENIC MEMORANDUM ACCOUNT****I. Summary**

This decision allows California Water Service Company (Cal Water) to establish a memorandum account to record approximately \$7.5 million of projected costs for complying with new Federal arsenic treatment standards for the Kern River Valley District. This application is closed.

**II. The New Arsenic Requirement
and Related Compliance Costs**

The new arsenic standards, adopted by the Federal Environmental Protection Agency (EPA), will become effective on January 23, 2006, and lower the allowable maximum contaminant level (MCL) for arsenic in water from 50 micrograms¹ per liter ($\mu\text{g}/\text{L}$) to 10 $\mu\text{g}/\text{L}$.² Cal Water's Kern River Valley

¹ 1 gram (gm) = 1,000 milligrams (mg) = 1,000,000 micrograms (μg).

² See EPA, *Implementation Guidance for the Arsenic Rule, Drinking Water Regulations for Arsenic and Clarifications to Compliance and New Source Contaminants Monitoring*, August 2002 (Arsenic Guidance), attached to Cal Water's Supplemental Prepared

Footnote continued on next page

District serves several communities in Kern County, and has 4,800 active water connections. Many wells and other facilities serving the Kern River Valley District require modification or removal to meet the new, lower arsenic standard. Cal Water is planning different treatment methods in different parts of the District, including construction of pipelines and treatment facilities, replacement of wells, and consolidation of water sources.

III. Application

On February 17, 2005, Cal Water filed its application seeking recovery of \$7.5 million that it anticipated spending to achieve compliance. The Commission's Office of Ratepayer Advocates (ORA) initially challenged the \$7.5 million figure as excessive, and on July 20, 2005, Cal Water amended its application to seek \$4.9 million instead of \$7.5 million.

Since that time, however, Cal Water and ORA have agreed that Cal Water may establish a memorandum account recording approximately \$7.5 million in costs related to arsenic compliance. The parties have agreed that the account should be subject to a prudence/reasonableness review in Cal Water's pending General Rate Case (GRC). The GRC is Application (A.) 05-08-010. On November 8, 2005, the parties filed a joint stipulation to establish the memorandum account, along with a motion seeking approval of the stipulation.

This decision allows Cal Water to establish the memorandum account, subject to a prudence/reasonableness review in A.05-08-010, or thereafter if necessary for reasons of timing.

Testimony as Exhibit C and available on the Internet at
http://www.epa.gov/safewater/ars/pdfs/regguide/ars_final_mainguide_9-13.pdf.

IV. Discussion

A. Standards for Approving Memorandum Accounts

A memorandum account allows a utility to isolate and list costs related to a particular activity, and later to seek to recover those costs in rates. We require such recovery from pre-approved memorandum accounts to avoid unlawful retroactive ratemaking:

It is a well established tenet of the Commission that ratemaking is done on a prospective basis. The Commission's practice is not to authorize increased utility rates to account for previously incurred expenses, unless, before the utility incurs those expenses, the Commission has authorized the utility to book those expenses into a memorandum or balancing account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking.³

Recovery is not automatic. Rather, a utility must be able to show that the costs in the memorandum account are reasonable. We explained this requirement in D.04-03-039,⁴ another case involving a regulated water company's recordation of costs associated with water contaminants,

when the Commission authorizes creation of a memorandum account, it only allows for the recordation of certain costs in that account. Before a utility can recover in rates the costs recorded in the account, the utility must demonstrate the reasonableness of the costs. [A water company's request for establishment of such an account] seeks only the creation of various water quality memorandum accounts, so that it may book, or record, its costs in

³ Decision (D.) 92-03-094, 43 CPUC 2d 596 (1992), 1992 Cal PUC LEXIS 236, at *7; *see also* 1999 Cal PUC LEXIS 906, at *15.

⁴ The Commission granted rehearing on certain aspects of D.04-03-039 unrelated to the memorandum account issue, and issued D.04-04-069 to address those unrelated issues.

those accounts. When [the water company] seeks to recover the costs, it will apply to the Commission to do so, and will demonstrate the reasonableness of those costs.

D.04-03-039 only allowed the water company to post costs that were truly incremental, and not already recovered in rates:

The costs booked to the memorandum account must be the incremental capital costs and expenses. We emphasize incremental. The utility must be able to demonstrate that existing rates do not directly or indirectly already include consideration for the recovery of these costs. If they do, the utility must be able to show that appropriate consideration of those costs was given in determining what the incremental costs in the memorandum account should be. . . . They should be net of any previously recovered costs related to the old MCL activities replaced or augmented by the new MCL activities.

Here, the parties have agreed that Cal Water's costs must be incremental. Thus, any costs that Cal Water incurs to comply with the new, lower arsenic threshold must truly be new costs. Costs related to compliance with the old threshold may not be added to the memorandum account. Thus, Cal Water must segregate such new costs, and must demonstrate that it has done so when it seeks recovery in rates of the costs in the arsenic memorandum account.

B. Approval of Parties' Settlement Agreement

Because all parties to the proceeding have agreed to establishment of the arsenic memorandum account, the case should be analyzed pursuant to the Commission's settlement rules. In order for a settlement to be approved by the Commission, the settlement must be: (1) reasonable in light of the whole record, (2) consistent with law, and (3) in the public interest. (Rule 51.1(e) of the Commission's Rules of Practice and Procedure.) Each element is present here.

1. Reasonableness in Light of the Whole Record

Here, all the parties are agreeing to is establishment of the memorandum account. Approval of a memorandum account under the circumstances present here is reasonable in light of the whole record because the costs are clearly necessary, and this decision reserves a determination on the reasonableness of the costs incurred to a later date. Cal Water will be permitted to seek recovery of its costs in rates only when the costs are known. At that time, it will be required to establish that the costs are directly related to complying with the new arsenic standard and are otherwise reasonable. Thus, the settlement meets the first criterion.

2. Consistent With the Law

We find that approving a memorandum account is consistent with the law. First, this decision treats Cal Water consistently with our prior decision approving an arsenic memorandum account, D.04-03-039. Second, Cal Water clearly has a legal obligation to lower the level of arsenic in its water supplies, and will incur costs to do so. Finally, to avoid retroactive ratemaking, a memorandum account is necessary so that Cal Water has the ability to recover in rates costs that it will be incurring in the near future. Thus, the settlement satisfies the second criterion.

3. In the Public Interest

Finally, we find that the settlement is in the public interest. Cal Water must lower the level of arsenic in its water supply to preserve the health and safety of its customers. It will necessarily incur costs to do so, and should therefore have a means of recovering those costs in rates at some future time. ORA has agreed to establishment of the memorandum accounts on the condition that the Commission later review the costs incurred for prudence and

reasonableness, and we order such a review in this decision. Under these circumstances, we find that the settlement is in the public interest and therefore meets the final criterion for approval.

For the foregoing reasons, the Commission finds that the settlement establishing an arsenic memorandum account for Cal Water is reasonable in light of the whole record, is consistent with the law, and is in the public interest. The settlement should therefore be approved and the memorandum account established.

C. Reasonableness Review of Account

The procedure for Cal Water to recover costs recorded to the memorandum account is not entirely clear in the parties' motion. They state that any decisions about whether Cal Water's costs are reasonable are deferred to its pending GRC, A.05-08-010. They also state, inconsistently, that they have agreed that Cal Water shall file new advice letters to recover costs in the account.

Cal Water may not be able to complete all of the work related to complying with the new arsenic standard before the Commission issues a decision in A.05-08-010. Indeed, given the magnitude of the work Cal Water describes—modification or removal of wells, construction of new pipelines, addition of treatment facilities—it seems unlikely that Cal Water will finish the work in time for the A.05-08-010 decision.

If Cal Water is unable to book all new arsenic compliance costs to the memorandum account before a decision mails in A.05-08-010, Cal Water shall file a new application seeking recovery of amounts in the arsenic memorandum account. Cal Water may not post more than \$7.5 million in the account—the amount on which the parties have settled.

V. Waiver of Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

VI. Assignment of Proceeding

Dian M. Grueneich is the Assigned Commissioner and Sarah R. Thomas is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. New rules adopted by the EPA will become effective on January 23, 2006, and lower the allowable MCL for arsenic in water from 50 µg/L to 10 µg/L.
2. Cal Water will need to upgrade its infrastructure to meet the new arsenic MCL.
3. Cal Water will incur cost to meet the new arsenic MCL.

Conclusions of Law

1. Ratemaking is done on a prospective basis. The Commission's practice is not to authorize increased utility rates to account for previously incurred expenses unless, before the utility incurs those expenses, the Commission has authorized the utility to book those expenses into a memorandum or balancing account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking.
2. The settlement establishing an arsenic memorandum account for Cal Water is reasonable in light of the whole record, is consistent with the law, and is in the public interest.
3. Cal Water should be allowed to establish an arsenic memorandum account to record costs related to meeting the new EPA 10 µg/L arsenic standard.

O R D E R

IT IS ORDERED that:

1. California Water Service Company (Cal Water) may establish a memorandum account to record costs related to meeting the new Federal Environmental Protection Agency arsenic standard of 10 micrograms per liter.
2. Costs posted to the arsenic memorandum account shall not exceed \$7.5 million.
3. Cal Water may recover in rates (not to exceed \$7.5 million) the reasonable and prudent costs in the arsenic memorandum accounts in one of two ways. If there is adequate time, it may seek such recovery as part of its general rate case, Application (A.) 05-08-010.
4. If Cal Water is unable to book all new arsenic compliance costs to the memorandum account before a decision mails in A.05-08-010, Cal Water shall file a new application seeking recovery of amounts in the arsenic memorandum account.
5. Cal Water may not recover costs from the arsenic memorandum account unless it meets its burden of proving such costs are reasonable and prudent.

6. The settlement between Cal Water and the Office of Ratepayer Advocates allowing establishment of the arsenic memorandum account is approved.

7. A.05-02-016 is closed.

This order is effective today.

Dated _____, at San Francisco, California.